INSTITUT C.D. HOWE INSTITUTE
Essential Policy Intelligence | Conseils indispensables sur les politiques

E-BRIEF

March 11, 2014

PENSION POLICY

Helping Ontarians Save for Retirement: How the Province Could Adapt the Canada Supplementary Pension Plan

by
Keith Ambachtsheer

"The critical question today is which political leader (and political party) will pick up the baton for the new round of pension reforms that are now required."

C.D. Howe Institute Commentary 265, May 2008.

- General agreement has emerged that Canada has a pension coverage problem. Many middle-income workers without a workplace pension plan are likely to face sharp reductions in their standard of living when they retire.
- Faced by a lack of federal-provincial consensus on how to solve the problem, the Ontario government has announced its intention to develop a made-in-Ontario solution to enhance the retirement income security of its citizens, and named former prime minister Paul Martin as Special Advisor.
- Rather than pursuing one of two existing solutions to the problem – a bigger Canada Pension Plan, or reliance on Pooled Registered Pension Plans (PRPPs) – this E-Brief recommends a middle way: the Ontario Supplementary Pension Plan, based on the author's previous proposal for a Canada Supplementary Pension Plan.

When the C.D. Howe Institute published the above-cited *Commentary* almost six years ago, there was already a growing consensus about an emerging pension problem. Specifically, many Canadian middle-income workers without a workplace pension plan were likely to face sharp reductions in

This paper has benefited greatly from a rigorous review process both inside the C.D. Howe Institute and by outside reviewers. Thanks especially to Bob Baldwin, Stephen Bonnar, Malcolm Hamilton, Claude Lamoureux, Alexandre Laurin, Bill Robson, Fred Vettese, Ed Waitzer, and Barbara Zvan. However, the views expressed in this final version of the paper are mine alone, as are any remaining errors and omissions.

their standard of living when they retire in the decades ahead. The *Commentary* placed the potential number of workers in that position in the area of 3.5 million.[1]

To address this looming challenge, I proposed a national supplementary retirement savings plan called the Canada Supplementary Pension Plan (CSPP). Its key features are set out in Box 1.[2] The 2008 CSPP proposal received considerable support from Canada's employer and labour communities, as well as from a number of provinces. However, this "middle way" option was literally voted off the island at the conclusion of the Federal-Provincial Finance Ministers' Conference held in PEI in June 2010. In its stead, two opposing solutions to Canada's workplace pension coverage problem have emerged. A "Big CPP" proponent group has been arguing for a mandated material increase in future CPP benefits. In the other camp are proponents of what I will call the "Little PRPP" solution. They believe the private-sector can solve the pension gap problem with little effort through a new form of voluntary pooled retirement savings vehicles called PRPPs.[3]

The "Big CPP" and "Little PRPP" Solutions: Both Problematic

In my view, the alternative solutions that have emerged both have material drawbacks. The "Big CPP" option would have to be mandatory, thus raising the hackles of "free choice" Canadians. Then there is the question of targeting: a mandatory "one-size-fits-all" solution would "help" a lot of people who don't need help. Further, the fact that future benefits would have to be fully pre-funded prompts serious questions that "Big CPP" proponents have not even begun to discuss. For example, what rate of return is being projected when costing the new accruing CPP benefits? Would it be the arguably optimistic net real return of 4 percent currently being used? Would these new benefits be guaranteed? If so, by whom? Surely not the next generation? If not guaranteed, how would the new benefits be adjusted for actual investment experience?[4]

All this has become hypothetical, at least until the next federal election. After the latest round of federal-provincial discussions on pension reform this past December 16, Mr. Flaherty announced flatly that the current federal government will not support this option.[5]

The "Little PRPP" option has its own set of issues. The Pooled Registered Pension Plan version already promulgated into law by the federal government is voluntary, and shares many similarities with Group RRSPs that have been available to Canadian employers for many years. As a counterpoint, Quebec has just passed legislation requiring employers to enrol their employees in qualifying PRPPs (called VRPPs). However, serious questions remain about the potential effectiveness of this approach. There is, for example, the imperative

1 A C.D. Howe Institute study by Moore, Robson, and Laurin (2010) estimated that 16 percent of Canadians retiring today experience material declines in their standard of living. They project that proportion will increase to 44 percent in the decades ahead for today's 25-30 year-olds.

2 For more detail see Ambachtsheer (2008).

3 I use "little" to indicate my judgement that PRPPs will likely have little impact on the looming retirement challenge.

4 All this is not to say that the questions posed have no answers. The message is that the "Big CPP" option has more unanswered difficult questions than many of its supporters seem to realize. For more CPP expansion criticism, see Robson's November 12, 2013 *Globe and Mail* article "'Big CPP' at young's expense" and his June 2011 C.D. Howe paper "Don't Double Down on the CPP."

5 Changing the *CPP Act* requires agreement of the federal government and two-thirds of the provinces with two-thirds of the population.

Box 1: Key Features of the CSPP Proposal

- Universal access for all Canadian workers without a workplace pension plan through automatic enrolment with an opt-out option. Employers not offering a qualifying pension plan are required to enrol their employees in the CSPP.
- Target pension (including OAS and CPP) set at 60 percent of final gross earnings over a 40-year work period.[a]
- A default contribution rate consistent with the target pension, with an employee-employer split of 50-50. Under a set of assumptions we believe to be reasonable, this default contribution rate is in the 6 percent of pay area, split 3 percent-3 percent between employees and employers. Both have options to contribute more or less than their default portion.[b]
- The CSPP should not harm low-income workers who will already achieve 100 percent income replacement through the combination of CPP, OAS, and GIS. For example, this could be done by exempting the first $25,000/yr from any CSPP deductions.[c]
- A default investment policy based on participant age and a deferred annuitization option for older workers and retirees.[d]
- CSPP investment, administration, and communication functions managed at low cost (e.g., 50 basis points or lower) by an arms-length expert pension agency with strong governance and management functions.

---

a As a simplified example, assume stable family earnings level of $70,000/yr for 40 years in real terms. The 60 percent income replacement target pension in this case would be $42,000/yr. If combined family OAS/CPP payments amounted to $30,000/yr, the target CSPP pension is $12,000/yr. See a forthcoming article titled "Filling the Pension Gap" by Fred Vettese in Morneau Shepell's house publication VISION for a more detailed exposition.

b Consistent with the simplified example above, generating a $12,000/yr pension for 25 years in real terms will require a 6 percent contribution rate (i.e.; $4,200/yr) for 40 years, assuming retirement savings earn a net real return of 2.5 percent over the entire 65-year accumulation/decumulation period.

c Such an exemption may require a higher contribution rate on non-exempt income to achieve the same 60 percent replacement target. As an alternative, contributors could be offered the choice to make tax-prepaid contributions, up to a maximum. See Pierlot and Laurin (2012) for more on this topic.

d Participants start accumulating capital through contributions and return compounding and then transition at least part of the accumulated capital into life annuities as workers transition into the post-work phase of their lives. See the article "Get big or die trying" in the 23 November 2013 issue of *The Economist* magazine for more on this idea. In the context of the CSPP, there will be an eventual requirement for a cost-effective annuitization option that currently does not exist in Canada today.

to create scale economies to control PRPP costs. Will this be possible with multiple vendors offering PRPP management services across the country? Next is the question of governments mandating employers to select a commercial PRPP vendor who is required to act as a "fiduciary." While this may be a reasonable requirement for larger, sophisticated employers, it is not for small unsophisticated ones. Further, it is no small task to design regulations – especially around fee structures – that will mitigate potential conflicts of interest and informational asymmetries between enrolled workers and PRPP administrators, while also ensuring that potential administrators could achieve the scale needed for success.[6]

So where does Canada go from here? Fortunately, as one window to pension reform has closed, another one has opened.

A New Pension Reform Window

As noted, the 2008 C.D. Howe *Commentary* closed with the observation that effective pension reform would require political leadership. Through its OAS/GIS and CPP/QPP arrangements, Canada's retirement income system already has a significant publicly provided component. The pension coverage problem that remains argues for taking a collective approach to our retirement income system one step further. Logic and experience suggest that achieving success in taking that additional step requires three things from government: (i) a viable, explainable vision to address the problem; (ii) the political will to see it through; and (iii), a properly resourced, effectively led effort to implement it.

Arguably, the CSPP proposal offers the basis for a viable, explainable vision to address the pension coverage problem. The recent announcement by the Ontario Government expressing its willingness to lead in solving the problem addresses the second element required for success. The existence of a viable vision, and a political will to see it through, set the stage for the third element down the road: a properly resourced, effectively led effort to implement it.

Two Major Risks

I see two major risks in bringing such a project to successful completion:

1. ***Clinging to a "Big CPP" implementation possibility down the road:*** it should be clear that seriously pursuing a "middle way" CSPP – or, in this context, an Ontario Supplementary Pension Plan (OSPP) option to address the private-sector, middle-income worker coverage problem also means letting go of the "Big CPP" option. Trying to ride both reform horses at the same time would amount to trying to solve the same problem twice, and due to the unnecessary complexities involved, lead to failure for both attempts.
2. ***An under-resourced, ineffective implementation effort:*** even without the confusion of attempting to implement a "Big CPP" option at the same time as a "middle way" CSPP or OSPP option, there is still a material risk of failure that would have to be mitigated. Failure could result from not

6 See the C.D. Howe Institute publication "Saving Pooled Retirement Savings Plans: It's Up to the Provinces," by Ambachtsheer and Waitzer (2011) for more on this issue.

7 A similar initiative is taking shape south of the border, with Senator Tom Harkin's recent introduction of the *USA Retirement Funds Act*.

investing the necessary resources required for success. It could also arise from governance and managerial failure to deliver a complex project on time and on budget.

Fortunately, both major risks can be mitigated. Making a serious commitment to develop and implement a middle-way CSPP or OSPP option will make it increasingly clear to all that only a completely focused effort with no distractions will produce a successful outcome. As for implementation risk, important "do and don't" lessons can be learned from two highly successful pension implementation projects. One was the creation of the National Employment Savings Trust (NEST) in the UK; the other was the creation of world-class pension organizations right here at home.

The NEST Story

The UK Pensions Commission chaired by Lord Turner produced its first report in 2004, and a follow-up report in 2005.[8] The Commission's four key findings were that 9 million UK workers were under-saving for retirement, the UK pension system was overly complex, UK longevity was rising while its birthrate was falling, and UK institutional arrangements for managing pensions were inadequate. Its recommendations had two main elements: first, a new policy for earnings-related pension provision which relied on the automatic enrolment of employees into either a new National Pensions Savings System or into existing company pension schemes, but with the right to opt-out, and with a level of compulsion on employers to make matching contributions; second, reform of the existing state pension system, including less means-testing.

The Commission recommended "the creation of a low-cost, national, funded pension savings scheme." The recommendation was accepted by the UK Government in 2006. In 2007, the arms-length Personal Accounts Delivery Authority (PADA) with an independent Board of Directors was created to "provide expert advice to the Government to develop the practical implementation of the new pension policy." PADA was transformed into the operating entity NEST in 2010.

UK legislation requiring employers to enrol their employees in a pension plan with certain minimum features went into effect in 2011. Under that legislation, NEST began enrolling workers on a beta-test basis and had workers from 100 different employers participating in the plan by the end of March 2012. By December 2013, NEST had auto-enrolled 700,000 UK workers without a pension plan. Under the same legislation, an additional 1.5 million workers were auto-enrolled in other qualifying plans offered by commercial providers chosen by the employers of these workers. Around 8 percent of all enrolled workers exercised their option to dis-enroll themselves. Perhaps not surprisingly, most were higher-income workers close to retirement. Looking ahead, NEST faces the daunting task of auto-enrolling millions of additional UK workers over the course of the next two years.[9]

On the financial side, the creation of PADA and then NEST was made possible by a loan provided by the UK Government. At the end of March 2013 the Government loan to NEST was £239m.[10] The loan agreement signed in 2011 allows for NEST to borrow up to £650 million by 2020, although with ongoing changes in the policy

8 UK Pensions Commission. 2004. "Pensions: Choices and Challenges," The First Report of the Pensions Commission. UK Pensions Commission. 2005. "A New Pensions Settlement for the Twenty-First Century," The Second Report of the Pensions Commission.

9 It is expected that most of the remaining workers will end up in the NEST plan by default, as they are attached to small employers or are self-employed. This makes them commercially unattractive to commercial providers, given NEST's low fee structure. For more, see Jones (2009).

10 National Employment Saving Trust Corporation Annual Report and accounts 2012-2013.

and economic environment, this number will be kept under review.[11] On the revenue side, NEST is charging its participants a 0.3 percent per annum management fee on assets under management, as well as a 1.8 percent one-off charge on contributions to recover the start-up costs. Together, the two charges are, for the average member, equivalent to about 0.5 percent of assets per annum.[12]

The "Maple Revolutionaries" Story

The Rowan Task Force on public-sector pension reform in Ontario tabled its report "In Whose Interest?" in 1988. One of its recommendations was to re-organize the Ontario Teachers' Pension Plan into a modern, world-class pension institution. According to the Report, the successful implementation of this recommendation would require three things: (i) the creation of a legal structure at arms-length from government and a clear organizational mission; (ii) the appointment of a publicly spirited Board of Directors with the requisite skills and experience to oversee a complex financial institution; and (iii) a compensation philosophy that would allow the organization to be competitive in the markets for the talent needed to become a world-class pension organization.

A number of rounds of discussion between the Ontario Government and the Ontario Teachers' Federation followed, leading to agreement to implement the Report's key recommendations in 1990. Gerald Bouey, the just-retired Governor of the Bank of Canada, was appointed OTPP's first Board Chair. A strong Board was installed, and Claude Lamoureux, a senior insurance industry executive, agreed to become OTPP's first CEO. Together with CIO Bob Bertram, Lamoureux and his executive team went from there to create what has arguably become the global gold standard for organizations in the businesses of pension investment and benefit administration. Over time, other Canadian pension organizations (e.g., CPP Investment Board, BC Investment Management Corporation, Alberta Investment Management Organization) have adopted the revolutionary Teachers' organization model, leading *The Economist* magazine to note their collective success in an article titled "Maple Revolutionaries" in its March 1, 2012 edition.[13] The point is that, regardless of the specific design of the pension formula, Canada has become a world leader in the design, governance, and management of pension institutions.

The Road Ahead

So where does Canada's pension reform story go from here? Maybe the most important message of this paper is that the future lies in finding a viable "middle way" between the duelling "Big CPP" and "Little PRPP" options.

---

11 Freedom of Information question about the loan agreement between NEST and Government https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220807/foi_release_redacted_loan_agreement_DWP_and_nest_04082011.pdf.

12 By comparison, the cost of participating in a Group RRSP in Canada can easily exceed 1 percent of assets per annum, while individuals investing their RRSP assets through retail mutual funds often pay 2 percent per annum or more. Standardized, comparable, comprehensive cost data are very difficult to come by. Insurance industry providers of DC plan services in Canada claim to be offering these services to some clients at fee levels of 70bps or even less. The median cost of operating multi-billion dollar corporate DC plans in the USA is about 35 basis points according to data provided by CEM Benchmarking Inc. As a rule of thumb, all other things equal, a fee reduction from 2.0 percent of assets to 0.5 percent assets will increase a worker's pension by some 40 percent.

13 For more, see Lamoureux (2008). Ontario Teachers' ranks #1 on a 'value for money' basis for both its investment and pension administration functions in the CEM Benchmarking Inc. database for measurement periods in excess of 10 years. CEM benchmarks the organizational investment and benefit administration 'value for money' performance of over 300 pension organizations globally.

With Ontario now finding itself the "lead wagon" on this journey, the province is facing a number of important decisions. For example:

- Is the province prepared to explicitly choose a "middle way" to pension reform with the basic features of the 2008 CSPP proposal, which is now being implemented in the UK?[14] Arguably, these features combine the best elements of traditional DC and DB plans (e.g., a target pension, clear property rights, no intergenerational wealth shifting, lifetime income, opt-out option).
- Is the province prepared to require employers not already offering a qualifying pension arrangement to enroll their employees in a qualifying arrangement, as Quebec has already done?
- Is the province prepared to appoint an expert task force charged with designing and creating a new arms-length pension agency that would finalize the design of, and administer an OSPP?
- Will it find an acceptable way for commercial vendors to participate in this newly created market for pension services?

If the answer to these questions is "yes," this E-Brief points to three success drivers the province should keep in mind: first, a viable, explainable vision to address the pension coverage problem; second, the political will to see it through; and third, a properly resourced, effectively led effort to implement it. In this context, the NEST and "Maple Revolutionaries" stories are instructive for three reasons:

1. ***Both stories confirm the three success drivers rule:*** (i) the Turner and Rowan Commissions defined the problem and a solution for fixing it; (ii) the UK and Ontario Governments of the day committed to transforming the "on paper" solution into an actual solution;[15] (iii) both governments created properly resourced, effectively led efforts that successfully managed the transformation.
2. ***Getting it right takes a long time:*** the Turner recommendations were accepted by the UK Government in 2006. PADA was created in 2007. NEST became operational in 2011. The Rowan Report was tabled in 1988. The new OTPP organization was created in 1990. Arguably, it took another five years for it to become fully operational. The same has been true for the CPPIB, BCIMC, and AIMCO organizations.
3. ***Good governance is key:*** NEST and the "Maple Revolutionary" organizations show a collective mix of skill, experience, and "greater good" thinking has been essential to overcoming the many landmines and roadblocks these organizations experienced on the road to turning vision into reality.

Political leadership was necessary to address Canada's emerging pension coverage problem in 2008. Sadly, over the subsequent six years, too little has been done. Through Ontario's recent stated intention to now seriously address the problem, a new window of opportunity has opened. The CSPP solution, now bolstered by the NEST and "Maple Revolutionary" experiences, continues to offer the basis of a viable way forward.

---

14 An Ontario initiative along the lines of the CSPP proposal does not need to be purely provincial. In fact, the Ontario Government has said that it is interested in working with other governments to make it a multi-jurisdictional effort.

15 Note that in both cases, the organization's mission, as well as its legal and governance structures, were created first. The appointment of a Board Chair, the Board, and senior management followed. The resulting boards and senior management teams were given considerable leeway in devising the strategies that were most likely to achieve the organization's mission. In the proposed CSPP context, this would include such decisions as the default settings for the target retirement benefit and the contribution rate structure.

References

Ambachtsheer, Keith. 2008. *The Canada Supplementary Pension Plan (CSPP): Towards an Adequate, Affordable Pension for All Canadians.* Commentary 265. Toronto: C.D. Howe Institute. May.

Ambachtsheer, Keith, and Edward Waitzer. 2011. "Saving Pooled Retirement Savings Plans: It's Up to the Provinces." E-Brief. Toronto: C.D. Howe Institute.

Jones, Tim. 2009. "A Pension for All: Pension Reform in the United Kingdom," *Rotman International Journal of Pension Management*, Fall.

Lamoureux, Claude. 2008. "Effective Pension Governance: The Ontario Teachers' Story," *Rotman International Journal of Pension Management*, Fall.

Moore, Kevin D., William Robson, and Alexandre Laurin. 2010. *Canada's Looming Retirement Challenge: Will Future Retirees Be Able to Maintain Their Living Standards upon Retirement?* Commentary 317. Toronto: C.D. Howe Institute. December.

Pierlot, James, and Alex Laurin. 2012. *Pooled Registered Pension Plans: Pension Savior – or a New Tax on the Poor?* Commentary 359. Toronto: C.D. Howe Institute. August.

Robson, William. 2011. "Don't Double Down on the CPP: Expansion Advocates Understate the Plan's Risks." Backgrounder 137. Toronto: C.D. Howe Institute. June.

UK Pensions Commission. 2004. "Pensions: Choices and Challenges." The First Report of the Pensions Commission.

———————. 2005. "A New Pensions Settlement for the Twenty-First Century." The Second Report of the Pensions Commission.

Vettese, Fred. Forthcoming. "Filling the Pension Gap." Morneau Shepell's house publication VISION.

This E-Brief is a publication of the C.D. Howe Institute.

Keith Ambachtsheer is Director of the International Centre for Pension Management at the Rotman School of Management, University of Toronto. He participated in the design and implementation of the Ontario public sector pension reforms of the late 1980s and in the CPP reforms of the mid-1990s. He is currently a member of Ontario's Technical Advisory Group on Retirement Security.

This E-Brief is available at www.cdhowe.org.

Permission is granted to reprint this text if the content is not altered and proper attribution is provided.